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**Comments on MMS Proposed Rulemaking on
Relief of Reduction in Royalty Rates—Deep Gas Provisions
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by

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Introduction

El Paso welcomes the opportunity to comment on the Minerals Management Services ("MMS") proposed rule making regarding the suspension of royalties for shallow water deep gas. We are appreciative of the MMS's goal of seeking to provide economic incentives to encourage deep drilling, but believe that the proposed regulations fall far short of its intended goal of stimulating increased deep drilling. We look forward to a continued dialogue with the MMS to address the shortcomings and to address many areas of concern so that the result will be an effective rule in stimulating exploration and development of shallow water deep gas. El Paso is actively involved in exploration and production in the Gulf of Mexico and appreciates this opportunity to provide comments.

Comments on Preamble Questions:

Below you will find a list of questions found in the preamble of the proposed rule. Our comments and answers to these questions are as follows:

1. MMS is soliciting comments on two other RSV levels. Option B would provide 10 BCF for wells 15,000-18,000 feet deep, and 25 BCF for wells >18,000 feet deep. Option C would provide 10 BCF for wells 15,000-18,000 feet deep, and 20 BCF for wells >18,000 feet deep.

Comment: The volumes proposed by MMS are considered reasonable and are of an amount to positively impact the decisions being contemplated by lessees to drill deep gas prospects. The volumetric approach and amount of royalty suspension volume proposed by MMS is adequate. Unfortunately, the incentive envisioned by the volume suspension disappears with the proposed price threshold. The price threshold limitation on the royalty suspension imposes several barriers to the proposed rule becoming an effective economic stimulus of shallow water deep gas exploration and development in the near term. First, the possibility of a royalty suspension can not be included in our economic projections in determining whether or not to drill a well because prices will most likely exceed the threshold for some time, and as a result, the royalty suspension would not be realized. If the prices exceed the proposed price threshold, the royalty suspension volumes produced during those years will be forfeited. Second, accounting requirements and securities law requirements preclude including royalty suspension in a company's economics. For example, if payment of royalties on a qualifying well is suspended during year 1, the royalty must still be included in the accounting because the royalties would be paid with interest in the first quarter of year 2 if the prices rise above the price threshold. This also points out the additional accounting burdens and a financial burden of having to pay interest on what was intended to be an economic incentive to exploration and development.

An alternative would be to allow lessees to receive a volumetric royalty suspension up to the price threshold and not lose that suspension when prices exceed the threshold, but to pay royalties on the volumes produced in a year multiplied by that part of the price which exceeds the price threshold. Elimination of the royalty suspension forfeiture in the price threshold mechanism would provide economic certainty in project development, provide a reliable economic incentive to exploration and development of shallow water deep gas, allow compliance with accounting requirements, and eliminate the financial disincentive imposed by the make-up of payment of royalties plus interest at a later date. The forfeiture of royalty suspension in the price mechanism results in a rule that does not adequately provide for an economic incentive to stimulate shallow water deep gas exploration and development. Instead, the forfeiture of royalty suspension in the price threshold mechanism results as a windfall for those lessees who would otherwise drill and develop the deep gas regardless of the royalty suspension and who fortuitously produce during a time when prices are below the threshold.

An even better alternative would be to abandon the volumetric royalty suspension mechanism in favor of an economic incentive similar to that provided by some states for the suspension of severance taxes. An economic incentive based on a royalty suspension that would allow lessees to be relieved of the royalty burden up to a percentage of the lessee's costs in drilling a deep well would eliminate numerous concerns regarding planning, economic incentive, accounting, and fairness, as well as render moot the MMS's concern over sidetracking. With current prices, the price threshold mechanism in the proposed rule renders the proposed rulemaking an entirely academic exercise with no real economic impact to encourage deep drilling.

2. To help us assess the validity of this inference, MMS would like responses to the following question: In comparison to the proposed approach, under what conditions would a royalty

suspension volume or supplement allocated among several leases within a unit result in either more deep drilling or less administrative burden?

Comment: By restricting royalty suspension volumes to a lease, the program would be much easier to manage not only for the MMS, but also for industry. From a reservoir engineering perspective, a "lease-basis" program avoids the added duty of having to interpret the size and extent of newly discovered deep reservoirs, decide what is and what is not a unit reservoir (vs. a lease reservoir), and determine how to allocate that production among several leases. This is especially true with regard to units involving adjacent State leases, which leases are not going to be eligible for royalty suspension anyway. From a production engineering perspective, commingling, production measurement and metering of production issues could make the added cost of administering a "unit-basis" program prohibitive, and would most certainly require extensive MMS input. However, the "lease-basis" could possibly result in some unnecessary "drainage" wells. If the "unit reservoir basis" is used the measurement requirements of the proposed rule will increase the costs for wells to a level that will result in a disincentive to deep drilling. The estimated additional metering would cost up to \$400,000 per well.

As an additional comment to the "lease-basis" approach, the proposed rule should be revised to allow for qualification of wells on a "block-basis" where a lease covers more than one block. In developing the proposed rule, it appears that the MMS assumed that all leases consist of one block each. To encourage exploration and development of shallow water deep gas of leases which cover more than one block, the royalty suspension should be on a block basis or some appropriate acreage basis. Otherwise, the rule will not provide an economic incentive for exploration and development of deep gas reserves on those leases which cover more than one block or which cover substantial acreage.

3. Sidetracking

Comment: A sidetrack exploration from an existing well bore is not an uncommon practice in the Gulf of Mexico. Although, the practical ability to utilize an existing well bore for deep gas exploration and development is not probable because most existing well bores would not be adequate to enable use of the well bore and casing for a deep gas well, there are few circumstances when an existing shallow well bore design will allow the efficient or effective sidetracking to a deep geological target. The goal of the proposed rulemaking is to encourage deep exploration and production, not merely to encourage industry to spend more money than otherwise necessary. As a result, the availability of royalty suspension should not be differentiated between sidetracks from deep wells or shallow wells. As to offset distances, the royalty suspension should not be further complicated by offset distances. MMS should encourage the use of existing wells to drill, develop and produce deep gas opportunities, so that the limited areas where it is feasible will further the stated purpose of the rule. Certainly, if an existing well bore with appropriate casing could be utilized for a deeper well, without substantial mechanical risk, a sidetrack of such an existing well bore would be an economic alternative to drilling a completely new well. Without allowing a royalty suspension for sidetracks, the rule would deter drilling sidetracks in favor of drilling completely new wells. The proposed rule

could distort decisions in favor of more costly new deep wells. Thus, not allowing royalty suspension for sidetracks leads to economic waste and exploration at greater costs which are results that are contrary to the goals of the proposed rulemaking.

4. Auction Mechanism

MMS would like to solicit comments on an alternative mechanism to allocate royalty relief for existing leases. This approach will not be pursued for this rulemaking, but may be pursued for future allocations. MMS would like to solicit comments on the feasibility of this approach, as well as solicit inputs on alternative approaches to make the allocation of royalty relief more efficient. This approach would seek to allocate approximately the same total royalty relief, but would differ in that not all lessees would receive the same relief, with the objective of encouraging greater levels of overall drilling at lower or comparable Federal cost.

Comment: Either a royalty reduction, a volumetric royalty suspension system, or a royalty suspension based on a percentage of drilling costs would be the fairest and most effective means of stimulating deep gas exploration and development. An auction would only benefit those companies that would have drilled regardless of the economic incentives, defeats the purpose of providing an economic incentive (a return on the investment of an auction bid might never be realized), and would not accelerate development of deep gas. An auction mechanism should not be considered as an alternative mechanism for providing an incentive for accelerated exploration and development of deep gas.

5. Additional Comments

The proposed rule will terminate five years from the date of the final rule. Currently, the proposed rule would qualify only those wells that commence production within that five year period of time. The rule should be revised to enable royalty suspension for a well drilled prior to the end of the five year period and subsequently produces from the qualified depth. Due to possible weather, rig or other delays, allowing for a well drilled before the end of the five year period would not be contrary to the purposes of the rule and would encourage the exploration of deep gas while avoiding unintended loss of the availability of the royalty suspension.

Clarification is needed on situations discussed during the April, 2003 workshop in Houston, Texas held on the proposed rulemaking. In particular, expedited clarification is warranted in circumstances where a deep well was drilled prior to the publication date of the proposed rule, but no deep well is producing from the lease at this time. During the workshop, hypothetical situations were raised about whether a second deep well drilled after the first deep well and drilled after the publication date, but produced before the first well would qualify for the royalty suspension. The MMS voiced two conflicting views: one view was that the lease would qualify for the royalty suspension the other view was that the lease would qualify then would lose the royalty suspension if the first well was placed on production. No where in the preamble or in the proposed rule provides for a termination for the royalty suspension because of production after

the publication date. Due to the uncertainty arising from the MMS comments at the workshop and the immediate application of the proposed rule, expedited guidance is respectfully requested.

6. Comments on Text of the Proposed Rule:

In the following text of the proposed rule are suggested modifications for MMS's consideration.

PART 203 RELIEF OR REDUCTION IN ROYALTY RATES

1. The authority citation for part 203 continues to read as follows:

Authority: 25 U.S.C. 396 et seq.; 25 U.S.C. 396a et seq.; 25 U.S.C. 2101 et seq.; 30 U.S.C. 181 et seq.; 30 U.S.C. 351 et seq.; 30 U.S.C. 1001 et seq.; 30 U.S.C. 1701 et seq.; 31 U.S.C. 9701 et seq.; 43 U.S.C. 1301 et seq.; 43 U.S.C. 1331 et seq.; and 43 U.S.C. 1801 et seq.

2. Section 203.0 is revised by adding definitions for "deep well", "new well", "participating area", "reservoir", "royalty suspension supplement," "sidetracking operations," (Note: New definition) "successful qualified deep well," and "unsuccessful certified well" in alphabetical order to read as follows:

§ 203.0 What definitions apply to this part?

* * * * *

Deep well means a well drilled and completed with a perforated interval, the top of which is at least 15,000 feet true vertical depth below the datum at mean sea level (TVD SS), or a well drilled and completed with a perforated interval the top of which is at least 18,000 feet TVD SS (Note: Phrase added for clarification), or a well drilled but not completed to a target reservoir deeper than 18,000 feet TVD SS.

* * * * *

New well means a new well bore ~~that results from drilling that does not utilize~~ or an existing well bore where sidetracking operations for a deep well have been conducted. (Note: Language suggested would include sidetracking operations for royalty relief consideration. See previous comments.)

* * * * *

Participating area means that part of the unit area that is reasonably proven by drilling and completion of producible wells, geological and geophysical information, and engineering data to be capable of producing hydrocarbons in paying quantities.

* * * * *

Reservoir means an underground accumulation of oil or natural gas or both characterized by a single pressure system and segregated from other such accumulations.

* * * * *

Royalty suspension supplement means a royalty suspension volume generated from drilling an unsuccessful certified well and applied to royalties due on future royalty-bearing natural gas and oil production on, or allocated to, the same lease.

* * * * *

Sidetracking operations means a new deep well utilizing, in part, a well bore in existence prior to the drilling of the new deep well and located on or off the lease. *(Note: New definition to add sidetracking operations to the rule.)*

* * * * *

Successful qualified deep well means a new deep well completed on your lease:

(1) That begins drilling after March 26, 2003, and before [DATE THAT IS FIVE YEARS AFTER THE EFFECTIVE DATE OF THE FINAL RULE, and

(2) That produces natural gas, including gas associated with oil production before] from a depth equal to or greater than 15,000 feet deep TVD SS. *(Note: Added for clarity and to allow for delays in drilling.)*

* * * * *

Unsuccessful certified well means a new well drilled on your lease:

(1) Beginning after March 26, 2003,

(2) Beginning before [DATE THAT IS FIVE YEARS AFTER THE EFFECTIVE DATE OF THE FINAL RULE],

(3) Beginning before your lease produces, excluding test production, *(Note: Added for clarity and to eliminate any confusion regarding production associated with testing a well before actual commercial production commences.)* from a successful qualified deep well;

(4) To a depth of at least 18,000 feet true vertical depth below the datum at mean sea level (TVD SS);

(5) That targeted a reservoir identified by lessee or his designee *(Note: Places the burden on lessee to identify the target reservoir.)* from seismic and related data deeper than 18,000 feet TVD SS; and

(6) That fails to meet the producibility requirements of 30 CFR Part 250, subpart A, from depths equal to or greater than 18,000 feet TVD SS *(Note: Added for clarity.)* and does not produce, or that MMS agrees is not commercially producible from any depth equal to or greater than 18,000 feet TVD SS. *(Note: Added for clarity.)* (Any well producing from a reservoir 15,000 feet TVD SS or deeper is deemed a successful well, though not necessarily a successful qualified deep well. In addition, a well drilled to at least 18,000 feet TVD SS but completed only at a depth above 15,000 feet TVD SS will not disqualify the well from being classified as an unsuccessful certified well). *(Note: Added for clarity and to assist in eliminating any confusion regarding when the royalty supplement would be applicable.)*

* * * * *

3. A new undesignated heading and new §§ 203.40 through 203.48 are added to read as follows:

ROYALTY RELIEF FOR DRILLING DEEP GAS WELLS

§ 203.40 Which leases are eligible for royalty relief as a result of drilling deep wells?

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Your lease may receive a royalty suspension volume under sections 203.41 through 203.43 and may receive a royalty suspension supplement under sections 203.44 through 203.46 if it:

(a) Was issued in an OCS lease sale held before January 1, 2001, or in a lease sale held on or after that date and the lessee has exercised the option under § 203.48, or a lease validated under Section 6 of the Outer Continental Shelf Lands Act of 1953, as amended *(Note: Added to include leases in the OCS not issued pursuant to a lease sale.)*;

(b) Is located in the Gulf of Mexico, wholly west of 87 degrees, 30 minutes West longitude—~~entirely~~ any portion of which is located *(Note: The word “entirely” was deleted, and the new phrase added to include all leases where any portion of the block is in water depths of 200 meters. Adding this language will allow a few additional leases in the Gulf of Mexico to be subject to potential royalty relief for deep gas drilling. We consider this beneficial and should be included as part of the area being considered for incentives.)* in water less than 200 meters deep; and

(c) Has not produced gas or oil, with the exception of test production, *(Note: Added for clarity and to eliminate any confusion regarding production associated with testing a well before actual commercial production commences.)* from a deep well that commenced drilling before March 26, 2003. Production before that date from a deep well on another lease on your unit does not make your lease ineligible for royalty relief.

§ 203.41 If I drill a successful qualified deep well, what royalty relief could I receive?

(a) Subject to the administrative requirements of § 203.43 and the price conditions in § 203.47, we will suspend royalties for the produced gas volumes, as reported in accordance with 30 CFR Part 216.53 (Oil and Gas Operations Report, Part A or OGOR-A), shown in the following table (in billions of cubic feet or BCF):

| If you have a successful qualified deep well. . . | then, we suspend royalties on this volume of deep gas production from or allocated to your lease as prescribed in this section and § 203.42: |
|--|---|
| (1) From 15,000 to less than 18,000 feet TVD SS | 15 BCF* |
| (2) 18,000 feet TVD SS or deeper | 25 BCF* |

* (New wells which include Sidetracking operations that ultimately are successful qualified deep wells shall be entitled to suspension of royalties for volumes of 10 BCF for wells completed between 15,000 feet to less than 18,000 feet TVD SS, and 20 BCF for wells completed at a depth of 18,000 feet TVD SS or deeper.) *(Note: This language is suggested to allow the incentive to utilize existing well bores to encourage deep gas drilling earlier than later while adjusting the entitled royalty relief volume for the perceived reduction in drilling cost associated with using a part of an existing well bore.)*

(b)(1) The royalty suspension volume determined under paragraph (a) for the first successful qualified deep well on your lease establishes the total royalty suspension volume available for that lease. You will not receive an additional royalty suspension

volume if you drill more successful qualified deep wells on your lease or if you later drill and complete a deeper well that would have qualified for a higher royalty suspension volume. For example, if you drill a successful qualified deep well to 16,000 feet TVD SS and later drill a second successful qualified deep well on the lease to 19,000 feet TVD SS, your total royalty suspension volume is limited to 15 BCF. If your lease is within an MMS-approved unit, see subparagraph (3) of this paragraph.

(2) After you receive a royalty suspension volume for your first successful qualified deep well, if you later begin production from another successful qualified deep well on the lease, or begin production from a well existing on the lease prior to the first successful qualified deep well, (*Note: Language added to ensure all available well bores could be utilized to produce new gas.*) you must notify MMS of that production under §203.43.

(3) This paragraph applies if your lease is within an MMS-approved unit.

(i) If the first successful qualified deep well on your lease is a well within a unit participating area, 100 percent of the royalty suspension volume available for that well under paragraph (1) of this subsection applies only to your allocated share of production from that well. No other lease in the unit is entitled to any of the royalty suspension volume under this section or §203.42, even though another lessee may be entitled to a share of the production from the successful qualified deep well on your lease. Your royalty suspension volume for the lease will not increase if your lease is entitled to an allocated share of production under the unit agreement from another deep well either on your lease or another lease in the unit.

(ii) If the first successful qualified deep well located on your lease was not a unit well, and if your lease is entitled to an allocated share of production under an MMS-approved unit agreement from another deep well within the unit participating area either on your lease or on another lease, that allocated share of production will not increase the volume of royalty suspension you qualify for under this section based on the first successful qualified deep well on your lease.

(iii) If you do not have a successful qualified deep well located on your lease, then you are not entitled to any royalty suspension volume for production allocated to your lease under the unit agreement from a successful qualified deep well on another lease in the unit.

(iv) Notwithstanding the provisions stated above, when a successful qualified well has been drilled within a unit, MMS will have the discretion to grant royalty suspension volumes in amounts equal to the suspension volume stated in § 203.41 for each lease included in the unit after determining a successful qualified well is not necessary to be drilled on each lease in the unit to efficiently develop the discovered reservoir. Should the MMS exercise this discretionary authority, the provisions of § 203.40, 203.41 and 203.42 shall apply to each lease in the unit granted a royalty suspension volume. (*Note: By adding this language to the proposed rule, MMS is given the discretionary authority to give all leases in a unit royalty relief without the necessity of drilling wells on each lease. Due to the fact many deep reservoirs contain high geological pressure fewer wells most likely will be needed to extract the recoverable hydrocarbons when reservoir sands are continuous. Maximizing recoverable reserves with the minimum number of wells drilled*

is prudent reservoir management. Requiring wells to be drilled on all leases in a unit to earn royalty relief promotes inefficient reservoir development.)

(c) Any royalty relief allowed under paragraph (a) of this section is in addition to any royalty suspension supplement for your lease under § 203.44 that results from a different well bore.

(d) You must pay minimum royalties in accordance with your lease terms notwithstanding any royalty suspension volumes allowed under paragraph (a) of this section.

§ 203.42 To which production do I apply the royalty suspension volume from drilling a successful qualified deep well on my lease?

(a) This paragraph applies to any lease that is not within an MMS-approved unit. Subject to the requirements of §§ 203.40, 203.41, 203.43, 203.44, and 203.47, beginning on the day date of your letter where (Note: Added for clarification and to eliminate any confusion as to the day royalty suspension begins to apply.) you provide MMS the notice required under § 203.43, you must apply the royalty suspension volume to production from all successful qualified deep wells, or those existing wells capable of producing from the deep gas reservoir(s) drilled prior to the successful qualified deep well being drilled (Note: This phrase has been added to cover the possibility of using existing well bores to participate in the extraction of newly discovered reserves found in new deep reservoirs. Some existing wells could be sidetracked to exploit a new reserve. The language is suggested to cover this contingency to not eliminate a viable option for efficiently developing newly discovered reservoirs.), on your lease for which you have given notice. Apply the royalty suspension volume applicable to your lease to that production each month until you use all of your royalty suspension volume.

(b) This paragraph applies to any lease all or part of which is within an MMS-approved unit and that has at least one successful qualified deep well located on the lease. Subject to the requirements of §§ 203.40, 203.41, 203.43, 203.44, and 203.47, beginning on the day date of your letter where (Note: Added for clarification and to eliminate any confusion as to the day royalty suspension begins to apply.) that you provide MMS the notice required under § 203.43, you must apply the royalty suspension volume to your share of production from all successful qualified deep wells, or those existing wells capable of producing from the deep gas reservoir(s) drilled prior to the successful qualified deep well being drilled (Note: This phrase has been added to cover the possibility of using existing well bores to participate in the extraction of newly discovered reserves found in new deep reservoirs. Some existing wells could be sidetracked to exploit a new reserve. The language is suggested to cover this contingency to not eliminate a viable option for efficiently developing newly discovered reservoirs.), on your lease for which you have given notice, and to production volumes allocated to your lease from deep wells on other unit leases drilled after March 26, 2003. Apply the royalty suspension volume applicable to your lease to that production each month until you use all of your royalty suspension volume.

(c) Unused royalty suspension volume automatically (Note: Added for clarification and the let lessees know no action is require to transfer the unused volumes.) transfers to a successor lessee and expires with the lease.

(d) You may not apply the royalty suspension volume allowed under § 203.41;

(1) To production from a deep well drilled before March 26, 2003, unless the production is obtained after the drilling of a successful qualified deep well *(Note: Consistent with the thought that an existing well not qualifying as a successful qualified deep well initially but subsequently able to produce from deep reservoir encountered in a successful qualified deep well drilled later on the lease.)*;

(2) To production from wells less than 15,000 feet TVD SS;

(3) To deep production from any other lease, except as provided in paragraph (b) of this section.

(e) You must begin paying royalties when the cumulative royalty-free production of gas from or allocated to your lease reaches the applicable royalty suspension volume allowed under § 203.41. For the month in which cumulative production reaches this royalty suspension volume, you owe royalties on the portion of gas production that exceeds the royalty suspension volume remaining at the beginning of that month.

(f) All liquid hydrocarbon volumes are subject to royalty. This includes condensate recovered at separation facilities without processing. If you sell your gas before it is processed, the royalty suspension volumes apply to the gas production reported on the OGOR-A. If your gas is processed before you sell it, the royalty suspension volumes apply only to residue gas generated after processing and not to any natural gas liquids.

§ 203.43 What administrative steps must I take to use the royalty suspension volume?

(a) You must provide written notification to the MMS Regional Supervisor for Production and Development of your intent to commence drilling operations on deep wells; and

(b) Within 30 days of commencement of production that qualifies for royalty suspension, you must:

(1) Notify the MMS Regional Supervisor for Production and Development that production has commenced; and

(2) Request confirmation of the size of the royalty suspension volume that applies to your lease.

(c) You must meet any special production measuring requirements that the Regional Supervisor for Production and Development has determined are necessary under 30 CFR 250, subpart L for royalty suspension volume. No special production metering requirements will be necessary for measuring a royalty suspension supplement (Note: Added for clarification.).

(d) If you commenced drilling a successful qualified deep well after March 26, 2003 and produced it before INSERT THE EFFECTIVE DATE OF THE FINAL RULE, you must provide the information required by paragraph (b) on or after INSERT THE EFFECTIVE DATE OF THE FINAL RULE and no later than INSERT THE DATE 30 DAYS AFTER THE EFFECTIVE DATE OF THE FINAL RULE.

(e) Should you fail to provide timely notice as provided under this § 203.43, MMS will have the discretion to deny your request for a royalty suspension volume. *(Note: Added to eliminate any confusion as to what would happen should a lessee fail to timely notify MMS of a pending deep gas well test.)*

§ 203.44 If I drill an unsuccessful certified well, what royalty relief could I receive?

(a) If you drill an unsuccessful certified well, and satisfy the administrative requirements of § 203.46, you will receive a royalty suspension supplement of five (5) (Note: Added for clarity.) BCF for your lease, to be applied to subsequent production of gas and oil, as reported in accordance with 30 CFR Part 216.53 (OGOR-A), on or allocated to your lease as provided in § 203.45. The conversion from oil to gas for using the royalty suspension supplement is specified in § 203.73.

(b) You may receive royalty suspension supplements for up to two unsuccessful certified wells per lease. You may not receive more than one royalty suspension supplement from a single well bore.

(c)(1) If the same well bore used to qualify for a royalty suspension supplement later produces from a perforated interval the top of which is 15,000 feet TVD SS or deeper no later than March 26, 2003, it will become a successful qualified deep well. If the completion of this successful qualified deep well is on your lease, then you must subtract that portion of the royalty suspension supplement that has been applied to other production from the lease from the royalty suspension volume remaining for the lease. The difference represents the maximum royalty suspension volume for which you are eligible on the lease. ~~If the completion of this successful qualified deep well is on another lease, then the royalty suspension volume earned by this other lease must be reduced by the full amount of the royalty suspension supplement applied on your lease.~~ (Note: This sentence was deleted due to the fact it is inconsistent with the rest of the rule and is suggested to be deleted. Royalty relief and supplement are being applied on a lease basis throughout the rule. This sentence states that a completion of a well on another lease would require reducing the royalty suspension volume on your lease where the completion was not made.) You may not use any remaining unused portion of the royalty suspension supplement earned for that well bore. (2) Notwithstanding any other provision of this part, the total amount of royalty relief earned from or applied to production from a single well bore that originally qualified as an unsuccessful certified well, but that later produces, cannot exceed 25 BCF.

(d) You must pay minimum royalties in accordance with your lease terms notwithstanding any royalty suspension supplements under this section.

§ 203.45 To which production do I apply the royalty suspension supplements from drilling one or two unsuccessful certified wells on my lease?

(a) Subject to the requirements of §§ 203.40, 203.42, 203.44, and 203.47 and beginning the first day of the month that you file the data and written (Note: Added for clarification.) request under § 203.46, you must apply royalty suspension supplements stipulated in § 203.44 to production from, or allocated under an approved unit agreement to, the lease that was the target of your drilling, without restriction on the drilling depth of the well producing the gas or oil.

(b) If you have a royalty suspension volume for the lease under § 203.41, you must exhaust the royalty suspension volume before applying any unused royalty suspension supplement to deep gas production.

(c) If you have no production on which to apply the royalty suspension supplement allowed under § 203.44 when it is earned, your royalty suspension supplement applies to the earliest subsequent production on your lease. Unused royalty suspension supplements automatically (Note: Added for clarification and to let lessees know no action is required to transfer the unused volumes.) transfer to a successor lessee and expire with the lease.

(d) You may not apply the royalty suspension supplement allowed under § 203.44 to production from any other lease, except for production allocated to your lease from an approved unit agreement. If the unsuccessful certified well is on a lease subject to an MMS-approved unit agreement, the lessees of other leases in the unit may not use any portion of your royalty suspension supplement.

(e) You must begin or resume paying royalties when cumulative oil and gas production from or allocated to your lease (excluding any deep gas produced subject to a royalty suspension volume allowed under § 203.41) reaches the applicable royalty suspension supplement. For the month in which the cumulative production reaches this royalty suspension supplement, you owe royalties on the portion of gas or oil production that exceeds the amount of the royalty suspension supplement remaining at the beginning of that month.

(f) If there is more than one lessee on a lease reporting production on the OGOR-A, and subject to the notice requirements under § 203.43 and § 203.46, production attributable to the operator which provided such notice to the MMS will be credited with the royalty supplement. (Note: This sentence is suggested to cover the contingency of multiple operators on a lease reported production from different platforms and reservoirs. This will assist in administering the royalty supplement between different operators.)

§ 203.46 What administrative steps must I take to obtain and use the royalty suspension supplement?

(a) Before a deep well targeted to a reservoir on your lease commences drilling, you must notify, in writing, the MMS Regional Supervisor for Production and Development of your intent to begin drilling operations; and

(b) After drilling the well you must:

(1) Provide MMS with data, including any well test data, that allows MMS to confirm that you drilled an unsuccessful certified well as defined under § 203.0. You must submit this data within 60 days after reaching the Total Depth (TD) in your well to be eligible for the royalty suspension supplement under § 203.45; and

(2) Request confirmation that the royalty suspension supplement applies to your lease.

(c) If you commenced drilling an unsuccessful certified well after March 26, 2003 and finished it before INSERT THE EFFECTIVE DATE OF THE FINAL RULE, you must provide the information required by paragraph (b) on or after INSERT THE EFFECTIVE DATE OF THE FINAL RULE and no later than INSERT THE DATE 60 DAYS AFTER THE EFFECTIVE DATE OF THE FINAL RULE.

(d) Should you fail to provide timely notice as provided under this § 203.46, MMS will have the discretion to deny your request for a royalty suspension supplement. (Note: Added to eliminate any confusion as to what would happen should a lessee fail to timely notify MMS of a pending deep gas well test.)

§ 203.47 Do I keep royalty relief if prices rise significantly?

(a) You must pay royalties on all gas and oil production for which royalty suspension otherwise would be allowed under §§ 203.40 through 203.46 in any calendar year when the average NYMEX natural gas price exceeds the threshold of \$5, but only as to the incremental increase of the price received by the lessee exceeding \$5 (Note: This would allow the proposed rule to give economic certainty in economic evaluations of deep gas projects, eliminate problems in accounting and reporting, and encourage exploration and development. If a threshold will be used, a higher threshold number of \$7 is suggested.) per million British thermal units (Btu), adjusted annually from year 2000 for inflation. The threshold price is adjusted by the percentage that the implicit price deflator for the gross domestic product changed during the preceding calendar year.

(b) You must pay any royalty due under this section, plus late payment interest under 30 CFR § 218.54, no later than 90 days after the end of the calendar year for which you owe royalty.

(c) Production volumes on which you must pay royalty under this section count as part of your royalty suspension volume and royalty suspension supplements.

(d) Your obligation to pay royalties will continue to be suspended even after the threshold price is reached in a previous calendar year subject to § 203.47 (b) above. *(Note: Added to clarify the obligation of lessees in regard to their continuing royalty responsibilities since the proposed procedure is contrary to certain existing royalty relief procedures currently in place in the regulations under 30 CFR Part 203.)*

§ 203.48 May I substitute the deep gas drilling provisions in § 203.0 and §§ 203.40 through 203.47 for the deep gas royalty relief provided in my lease terms?

(a) You may exercise an option to replace the applicable lease terms for relief related to deep gas drilling with those in §203.0 and §§ 203.40 through 203.47 if you have a lease issued:

(1) From a lease sale held after January 1, 2001, and before **INSERT THE EFFECTIVE DATE OF THE FINAL RULE**; and

(2) Wholly west of 87 degrees, 30 minutes West longitude in the Gulf of Mexico ~~entirely~~ any portion of which is located (Note: The word "entirely" was deleted, and the new phrase added to include all leases where any portion of the block is in water depths of 200 meters. Adding this language will allow a few additional leases in the Gulf of Mexico to be subject to potential royalty relief for deep gas drilling. We consider this beneficial and should be included as part of the area being considered for incentives.) in water less than 200 meters deep, with royalty relief provisions for deep gas drilling.

(b) You may exercise this option by notifying the MMS Regional Supervisor for Production and Development of your decision before **INSERT THE DATE 180 DAYS AFTER THE EFFECTIVE DATE OF THE FINAL RULE** and specifying the lease and block number.

(c) Once the option is exercised, you must meet all the activity and administrative requirements pertaining to royalty relief for leases eligible for deep gas royalty relief that were issued in an OCS lease sale held before January 1, 2001.

(d) Exercising the option under paragraph (a) of this section is irrevocable. If you do not exercise this option, your original lease terms apply.

§ 203.49 If my lease covers more than one block, is each block covered by the lease eligible for separate royalty relief?

This paragraph applies to any lease that covers more than one block. Each block covered by a lease is eligible for royalty relief provided by §§ 203.40 through 203.48 as if each block were covered by a separate lease. (Note: There are a few OCS leases in the Gulf where more than one block is covered by a single lease. This proposed provision allows royalty relief to be allowed for each block under the lease.)

El Paso appreciates the opportunity to submit its comments on the proposed regulation. El Paso welcomes further discussion on the proposed rule, on the comments submitted or any suggested changes to the proposed rule. Should you have any questions, please contact Mr. Norman D. Ewart at 832-676-6146.

Very truly yours,

/s/

Norman D. Ewart